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COMMENTARY • CHINA

China's digital yuan—premiering globally at the Beijing Olympics—could become a model for other countries

BY **ESWAR PRASAD**

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Eswar Prasad, author of "The Future of Money," notes how China's digital yuan might transform the country's domestic finances—and may serve as a template for other countries.

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As the Beijing Olympics get underway, the Games will feature not just athletic endeavors but an economic event freighted with symbolism. International visitors at the Olympic Village will for the first time get to experience the digital yuan.

The Olympics are part of a slow and steady rollout of China's central bank digital currency (CBDC). By the end of 2021, the digital yuan had 261 million users, up from just 21 million at the end of June 2021, although its share of the China's digital payments market is still small, notching about $8 billion in transactions over the past six months.

But what does the rollout of the digital yuan mean for China—and beyond? Despite concerns that the e-CNY threatens the dominance of the U.S. dollar, in fact, China's efforts to make a digital currency are focused internally—yet might still portend a real transformation in how the country's economy operates.

It's no coincidence that, as it advocates for the digital yuan, Beijing has cracked down on the two payment giants, Alipay and WeChat Pay, which currently dominate retail payments in China. This dominance has, in the government's eyes, reduced competition and innovation in the payment space. Moreover, the government is concerned about these companies' unwillingness to share their data with them.

In part to curb the growing economic and political power of the e-payment giants, China became one of the first major countries to commence CBDC trials: essentially, just digital versions of the paper currency and coins that central banks issue. China's trials of the digital yuan started in April 2020 as part of a broader initiative by China's central bank to improve retail payments. Beijing seems to be implementing a "learning by doing" strategy, conducting small-scale trials before rolling out the initiative nationwide.

The People's Bank of China (PBOC) states that the e-CNY is designed to provide widespread, cheap, and easy access to a digital payments system, thereby broadening financial inclusion and promoting more equitable growth. This aligns, of course, with Xi Jinping's goal of common prosperity. The e-CNY would also keep the central bank at the fulcrum of China's monetary system, even as the use of cash declines rapidly.

But is there a compelling use case for the digital yuan, especially after Alipay and WeChat Pay have blanketed the Chinese economy with low-cost, easily accessible digital payments? It's a rare individual or business that does not use one—or both—of these payment methods instead of cash.

The PBOC's argument is that leaving the payment infrastructure purely in private hands might be technically fragile and have weak privacy protections. Perhaps interestingly—given perceptions of what China's policy interests are—the e-CNY is ostensibly designed to allay concerns about disintermediation of the banking system, transactional privacy, excessive concentration in the payments industry, and security.

The e-CNY's two-tier design essentially means that the back-end infrastructure is provided by the PBOC, even as the front end is managed by private payment providers.

The government argues that it would be a better steward of consumer data than private payment providers. Low-grade digital wallets, with limits on balances and transaction amounts, can be registered with just phone numbers, compared with higher-grade wallets that must comply with more stringent regulatory requirements. The option of low-grade wallets that give users a greater degree of anonymity is an interesting approach to addressing concerns about transactional privacy.

The e-CNY's "loosely coupled" design would allow fund transfers without the need for a bank account, which would both promote broader use and further allay privacy concerns. Commercial banks and other financial operators will maintain the higher-grade non–interest-bearing e-CNY digital wallets while taking care of know your customer requirements and limiting fraudulent activity.

The digital yuan is thus designed to meet the government's interests. It would improve competition: Infrastructure that would cover different payment platforms would open the space to challengers of the Alipay and WeChat Pay giants. It might even help with setting monetary policy, the PBOC contends, by allowing the central bank to collect real-time data on the creation, bookkeeping, and circulation of money.

The PBOC appears open to someday allowing its use outside of China. Yet the notion that digitization of the yuan will dramatically expand its role in international finance is a chimera.

China's new digital currency and its cross-border payments system will together modestly enhance the renminbi's role as an international payment currency—if the government continues to reform the country's financial markets and remove restrictions on capital flows. But they will hardly put a dent in the dollar's status as the dominant global reserve currency. The dollar's strengths lie not just in the depth and liquidity of U.S. financial markets but also the institutional framework that underpins the currency's status as a safe haven.

The e-CNY could marginally improve the yuan's standing as an international payment currency but will not fundamentally threaten the dollar's status as the principal global reserve currency.

The digital yuan, instead, could come to be seen as a model—reshaping domestic finance in ways that may be a template for other countries considering their own digital currencies.

Eswar Prasad is a professor at Cornell University and senior fellow at the Brookings Institution. His new book is The Future of Money: How the Digital Revolution Is Transforming Currencies and Finance. *Follow him on Twitter at @EswarSPrasad*

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